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Cases, Regulations and Statutes

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• If a taxpayer identifies a transaction as a hedging transaction, and it is not a hedge, gains from the transaction are ordinary but losses are capital losses.22

• In the event a transaction meets the definitions of a hedge but it is not identified as a hedge, gains from the transaction are nonetheless ordinary and losses are capital losses.23

Thus, compliance with the regulations has been made the exclusive way to receive treatment as a hedge. That result has been criticized.24

**Treatment as a "regulated futures contract"**

Positions in "regulated" futures contracts are subject to the "marked-to-market" rules and are treated as if sold on the last day of the year.25 Gains or losses arising from those calculations are treated as if they were 60 percent long-term and 40 percent short-term without regard to the actual holding period.26 Hedging transactions are exempt from these rules.27

It would appear that hedge-to-arrive contracts are not "regulated futures contracts."28 A regulated futures contract must be "traded on or subject to the rules of a qualified board or exchange."29 Hedge-to-arrive contracts appear to have been outside the ambit of regulated futures activity.30

**FOOTNOTES**


2 See 4 Harl, supra n. 1, § 27.03[8][d]; Harl supra n. 1, § 4.02[6].

3 See Treas. Reg. § 1.1221-2(b) (defines hedges which produce ordinary losses). See also I.R.C. §§ 1092(e), 1256(e)(i).

5 I.R.C. § 1211(b).
6 I.R.C. § 1212 (h).
7 I.R.C. § 1212(a).
8 Treas. Reg. § 1.1446-4.
9 Treas. Reg. § 1.1446-4(b).
10 Id.
11 Id.
12 Treas. Reg. § 1.1446-4(e)(3).
14 Treas. Reg. § 1.1446-4(c).
16 Id.
17 Treas. Reg. § 1.1446-4(e)(6).
18 Id.
19 Treas. Reg. § 1.1446-4(e)(7).
20 Treas. Reg. § 1.1221-2(e).
21 Treas. Reg. § 1.1221-2(e)(1). The identification must be made “substantially contemporaneously” with entering into the hedge. An identification does not meet that test if made more than 35 days after entering into the hedging transaction. Treas. Reg. § 1.1221-2(e)(2)(ii)
25 I.R.C. § 1256(a)(1).
26 I.R.C. § 1256(a)(3).
27 I.R.C. § 1256(e)(1).
28 See I.R.C. § 1256(g)(1)(B).
29 Id.

**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr.

**ANIMALS**

**CATTLE.** A veterinarian informed the state police that neglected cattle were on the plaintiff’s property. One defendant, a state trooper, accompanied the veterinarian to the plaintiff’s farm and investigated the condition of the animals. The trooper filed a report with the county prosecutor who obtained a warrant for the seizure of some of the animals. The second defendant, also a state trooper, assisted in executing the warrant under which the cattle were seized by the local humane society which eventually sold the animals to cover maintenance costs. As a result of the second visit, another warrant was issued for seizure of the remaining animals. The third defendant, a state trooper, accompanied the humane society as it seized the animals. The plaintiff was eventually exonerated of animal neglect charges but by then all of the animals had been sold. The plaintiff sued all parties, with the state troopers as the only defendants in the current case. The plaintiff alleged that the state troopers violated the plaintiff’s due process rights and brought an action under 42 U.S.C. § 1983. The court upheld the dismissal of the case against the troopers because the troopers were properly executing court orders or were too removed from the sale of the animals to have participated in deprivation of the plaintiff’s property. Campbell v. Chappelow, 95 F.3d 576 (7th Cir. 1996).

**BANKRUPTCY**

**GENERAL-ALM § 13.03**

**ADMINISTRATIVE EXPENSES.** The debtor was a family farm partnership which operated a grain and dairy farm. The partners and their spouses also filed individual bankruptcy cases which were consolidated with the debtor’s case. During the pendency of the debtor’s case, a seed supplier sold on credit corn seed, fertilizer and two herbicides to the debtor for producing one year’s crop. The crop did not do well and the debtor complained to the...
supplier that the seed was defective and that the application method for the fertilizer and herbicide was ineffective. The supplier filed a priority administrative expense claim for the seed and chemicals. The other creditors objected to the claim, arguing that the estate was not benefited by the seeds and chemicals because the farm was to be sold as soon as possible. The court held that the seed and chemicals benefited the estate by continuing to keep the farm operational during the time it was offered for sale. The debtor argued that the claim should not be allowed because the seed and chemicals were defective. The court held that the debtor failed to show that the seed or chemicals were defective and that other intervening causes, such as low moisture and poorly operating equipment, were not responsible for the low yield. *In re Molnar Bros.*, 200 B.R. 555 (Bankr. D. N.J. 1996).

**EXEMPTIONS**

EARNED INCOME TAX CREDIT. The court held that the debtor's earned income tax credit was not eligible for an exemption under Ohio Rev. Code § 2329.66(A)(9)(e). *In re Beagle*, 200 B.R. 595 (Bankr. N.D. Ohio 1996).

PREFERENTIAL TRANSFERS. The debtors had owed money to the SBA. After that debt was due, the debtors contracted with the ASCS (now CFSA) for conservation programs under which the debtors would receive annual deficiency payments. The SBA instituted an administrative setoff which was properly approved by the ASCS. Some payments were made within 90 days before the debtors filed for bankruptcy and the trustee sought recovery of the setoff payments as preferential transfers. The court held that the ASCS and SBA lacked mutuality so that the setoff was not binding in the bankruptcy case and ordered recovery of the payments. Upon reconsideration, the court held that the offset did not improve the SBA position; therefore, the setoff was not subject to recovery. *In re Turner*, 96 F.3d 465 (10th Cir. 1996), on remand from 59 F.3d 1041 (10th Cir. 1995).

TRUSTEE LIABILITY. The debtor had operated a manufacturing business on real property and deposited waste from the manufacturing process on the land, contaminating the land and groundwater. The debtor filed for Chapter 11 and a trustee was appointed. The trustee, acting as trustee of the bankruptcy estate, transferred the land to the plaintiff. The debtor falsely submitted a Negative Declaration Affidavit with the state department of environmental protection, stating that no areas of environmental concern existed on the property. The sale was closed but the plaintiff later learned of the contamination. The plaintiff filed suit against all parties, including the trustee. The court held that the trustee did not have a fiduciary duty to the purchaser; therefore, the public policy of protecting trustees from suits by nondebtors prevented the trustee’s personal liability for the debtor’s misconduct. *Tenneco Corp. v. Estey Metal Products, Inc.*, 200 B.R. 542 (D. N.J. 1996).

**CHAPTER 13-ALM § 13.03.*"**

ALLOCATION OF PLAN PAYMENTS OF TAXES. The debtors’ Chapter 13 plan provided that all priority claims were to be paid in full but that unsecured claims would receive no payments. The IRS had filed a claim for taxes which consisted of some priority taxes and some unsecured general taxes. The debtors were entitled to a tax refund from a pre-petition tax year and the IRS sought permission to offset the refund against the tax claims, first against the unsecured tax claim and then against the priority tax claim. The trustee testified that the plan would not succeed if the refund was applied first to the unsecured taxes. The court held that it had the authority to exercise its equitable powers to order the IRS to allocate the refund first to the priority tax claim. *In re Moore*, 200 B.R. 687 (Bankr. D. Or. 1996).

**FEDERAL TAXATION-ALM § 13.03[7].**

CLAIMS. The debtors filed for Chapter 13 in September 1995. The debtors filed a claim for 1995 taxes for the IRS, arguing that the amount due for the first two estimated tax installments were pre-petition taxes. The court held that the 1995 taxes were not due until the end of the tax year, December 31, 1995; therefore, the 1995 taxes were all post-petition taxes. *In re Michaelson*, 200 B.R. 862 (Bankr. D. Minn. 1996).

DISMISSAL. The debtor’s Chapter 13 case was dismissed for failure of the debtor to file all income tax returns as ordered by the court. *In re Vines*, 96-2 U.S. Tax Cas. (CCH) ¶ 50,603 (M.D. Fla. 1996).

INTEREST. The debtor filed for Chapter 11 and the IRS filed an unsecured priority claim for employment taxes. The debtor’s plan was confirmed in August 1990, and in February 1991, the IRS assessed additional unpaid post-petition employment taxes. The debtor argued that the IRS was not entitled to post-petition interest on the filed claim and the post-petition assessment violated the automatic stay. The court held that, because the IRS claim was not discharged, post-petition interest continued to accrue. The court also held that, because the plan did not provide for the continuing of the automatic stay during the plan, the post-confirmation assessment did not violate the automatic stay. The case is designated as not for publication. *In re Gehri*, 96-2 U.S. Tax Cas. (CCH) ¶ 50,577 (Bankr. 9th Cir. 1996).

POST-PETITION TAXES. The debtors filed for Chapter 13 in September 1989 and the IRS filed claims for unpaid taxes for 1985 through 1988. The debtors timely filed their 1989 tax return and in June 1990 sought permission to add the 1989 taxes to the Chapter 13 plan. The IRS failed to object and the IRS subsequently modified its claims. The court held that post-petition claim were includible in the Chapter 13 plan only upon request of the creditor; therefore, the 1989 taxes could not have been included in the plan at the request of the debtors. *Matter of Epstein*, 200 B.R. 611 (Bankr. S.D. Ohio 1996).

RETURNS. The debtor filed an income tax return for the bankruptcy estate and then filed an amended return for the estate. The debtor requested a prompt determination...
with only the amended return. The amended return was accurate but failed to include the amount of taxable income listed on the original return. The IRS failed to notify the debtor that the return was selected for examination within 90 days after receiving the debtor’s request. The IRS argued that an exception to that rule applied because the amended return contained a material misrepresentation from the failure to include the taxable income from the original return. The court held that the omission of the original taxable income was not a material misrepresentation; therefore, the IRS was prohibited from challenging the amended return. In re Grassgreen, 200 B.R. 696 (Bankr. M.D. Fla. 1996).

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations changing the classification of New Mexico from a Class A to a Class Free state. 61 Fed. Reg. 58625 (Nov. 18, 1996).

CROP INSURANCE. The FCIC has adopted as final regulations which add specific provisions for sugar beets to the Common Crop Insurance Policy. 61 Fed. Reg. 58769 (Nov. 19, 1996).

The FCIC has issued proposed regulations which add specific provisions for peaches to the Common Crop Insurance Policy. 61 Fed. Reg. 58786 (Nov. 19, 1996).

The FCIC has issued proposed regulations which add specific provisions for dry beans to the Common Crop Insurance Policy. 61 Fed. Reg. 60049 (Nov. 26, 1996).

PEANUTS. The CCC has issued proposed regulations establishing the 1997 national peanut poundage quota as between 1,111,000 and 1,155,000 short tons and the additional price support level of between $125 and $140 per short ton. The minimum sales price for additional peanuts for export edible use is to be between $375 and $425 per short ton. 61 Fed. Reg. 59840 (Nov. 25, 1996).

FEDERAL ESTATE AND GIFT TAX

DISCLAIMERS-ALM § 5.02[6].* The decedent’s will bequeathed the entire estate, primarily the “home farm,” to the surviving spouse and provided that if the surviving spouse did not survive the decedent by at least 30 days, the estate passed to a trust for the decedent’s child. The surviving spouse disclaimed a portion of the estate that represented a fraction of the home farm sufficient to produce the smallest amount of assets in the estate which would result in the lowest possible estate tax liability. In other words, the disclaimed amount was to equal the amount which would be offset by the unified and other credits available to the estate. The disclaimed amounts passed under the will provisions for a remainder interest in trust in the decedent’s child. The IRS ruled that the disclaimer was effective. Ltr. Rul. 9645010, Aug. 12, 1996.

GIFT-ALM § 6.01.* The taxpayer owed taxes from involvement in a business. The taxpayer transferred title to the taxpayer’s residence to the taxpayer’s two minor daughters under the Illinois Uniform Transfers to Minors Act, reserving the right to live in the residence. The IRS argued that the gift lacked donative intent and transferred only bare legal title; therefore the residence remained available for attachment for payment of the taxpayer’s taxes. The taxpayer argued that the transfer was bona fide because it complied with state law. The court held that summary judgment for the taxpayer was improper at this point because the IRS provided sufficient evidence to rebut the presumption of a gift through transfer in compliance with the Illinois Uniform Transfers to Minors Act. United States v. Melcher, 96-2 U.S. Tax Cas. (CCH) ¶ 50,578 (C.D. Ill. 1996).

GROSS ESTATE. The taxpayer established an irrevocable trust which provided that the trustees had the discretion to distribute or accumulate trust income. At the death of the beneficiaries, the trustor and the trustor’s spouse, the trust terminated and trust corpus, except for assets contributed by persons other than the trustor and the trustor’s spouse, were to pass to the taxpayer’s children. The trustor and spouse made contributions in 1973, the couple’s children made contributions in 1974 and 1975 and the spouse’s estate was added to the trust in 1987. The IRS ruled that the trust was includible in the trustor’s estate only as to the property contributed by the trustor, based on the ratio of the fair market value of the contribution to the fair market value of the trust corpus at the time of the contribution, adjusted by the fair market value of later contributions by others. The IRS also ruled that the trust corpus was subject to GSTT only as to post-1985 contributions. Ltr. Rul. 9646021, Aug. 20, 1996.

The taxpayers, husband and wife each established an irrevocable trust. The beneficiaries of the wife’s trust included the husband and their children. The beneficiaries of the husband’s trust included only the children. The taxpayers served as trustee of each other’s trusts but all distribution powers were given to an independent co-trustee. The children and the husband had the power to require distribution of gift contributions to the trusts but not to exceed 5 percent of the trust corpus or $5,000. The taxpayers had limited powers of appointment over trust corpus. The IRS ruled that the only portion of the trusts included in the taxpayers’ estates was the value of the husband’s corpus withdrawal rights at the time of death. Ltr. Rul. 9643013, July 19, 1996.

MARITAL DEDUCTION-ALM § 5.04[3].* The decedent’s estate included an interest in a trust which passed to the surviving children. The residue of the estate passed to the surviving spouse and the estate claimed a marital deduction for the value of the entire residue, without any reduction for the residue’s share of inheritance and estate taxes. The decedent’s will provided language in three provisions for payment of inheritance and estate taxes from the estate other than the residue portion passing to the surviving spouse. Under the Ohio apportionment statute, taxes were not to be paid from bequests for which a marital deduction was available, unless the decedent’s will expressly assigned the taxes to specific bequests. The court found that the will and trust provisions were ambiguous in that the provisions could have been interpreted to include
the marital bequest as a source of payment of the taxes. The court held, therefore, that the decedent’s will did not expressly assign the taxes to all bequests and the apportionment statute applied to prohibit apportionment of the estate and inheritance taxes to the residue bequest which was eligible for the marital deduction. The court acknowledged rulings in the state probate court that agreed with this interpretation of the will, although the court was not bound by that ruling. Estate of Swallen v. Comm’r, 96-2 U.S. Tax Cas. (CCH) ¶ 60,248 (6th Cir. 1996), aff’d, T.C. Memo. 1993-149.

The decedent had established an inter vivos trust which would continue for the surviving spouse at the decedent’s death. The trust provided for distribution of all trust income to the surviving spouse, except during any period of incompetency. During the incompetency period, the trustee was to hold trust income in another trust for distribution to the spouse upon regaining competency. If the spouse died before regaining competency, the accumulated income passed to the remainder holders. The IRS ruled that the trust was not eligible for the marital deduction because the surviving spouse was not entitled to all trust income in all events. Ltr. Rul. 9645006, July 24, 1996.

SPECIAL USE VALUATION-ALM § 5.03[2]. * On the death of the decedent in 1983, the estate made the special use valuation election for farmland and the qualified heirs signed and filed the agreement to the election and to be liable for any recapture tax. Later, the IRS discovered that some of the land was rented for cash to third parties. The IRS issued a deficiency notice for recapture of the special use valuation benefits relating to the cash rented land. The heirs argued that the initial election was invalid and that the IRS had notice of the invalidity from the date of the election because the heirs included cash rent income on the estate’s Schedule F of the income tax return. Therefore, the statute of limitations had expired as to the election. The court held that, because some of the estate’s farmland was not included in the special use valuation election, the IRS could have reasonably assumed that the cash rents came from that land and not the special use valued land. In addition, the court held that the heirs were under a duty to file consistent returns and could not now claim a prior election as invalid when the heirs had acted for several years as if the election was valid. LeFever v. Comm’r, 96-2 U.S. Tax Cas. (CCH) ¶ 60,250 (10th Cir. 1996), aff’d 103 T.C. 525 (1994).

TAX LIEN. The taxpayer was a decedent’s estate. The decedent had bequeathed a portion of real property to a third party. The IRS had filed a tax lien for taxes owed by the third party and the lien was a cloud on the title to the property which the estate wanted to sell. The third party disclaimed any interest in the estate and the estate argued that the disclaimer had the effect of removing any interest of the third party in the property to which a lien could attach. The court held that under Texas law, a decedent’s estate property immediately vested in the named heirs and that this vesting was sufficient interest in the property for the lien to attach. The disclaimer was not effective under federal law to remove the lien. Estate of Leggett v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 60,249 (S.D. Tex. 1996).

VALUATION. The taxpayer owned a residence on 16.6 acres of beach property. The entire property had been used as a residence for 40 years and was not suitable for division. The taxpayer transferred the property to a six-year trust with the taxpayer as the sole income beneficiary. The trust could sell the property but was required to either purchase a replacement residence or distribute the corpus at the sooner of the trust termination or two years after the sale. The trust also provided that the trust corpus could not be sold directly or indirectly to the taxpayer or the taxpayer’s spouse. The trust also had the power to hold cash for the maintenance and improvement of the property. If the taxpayer died before the trust terminated, the trust corpus was to be distributed according to a power of appointment held by the taxpayer; otherwise, the trust corpus passed upon termination to the taxpayer’s children. The IRS ruled that the trust was a qualified personal residence trust. Ltr. Rul. 9645010, Aug. 2, 1996.

FEDERAL INCOME TAXATION

BAD DEBTS. The taxpayer had invested in real property for the purpose of developing the land for residential construction. As part of that plan, the taxpayer loaned money to a third party. The investment did not bear fruit and the third party filed for Chapter 7 bankruptcy. The taxpayer claimed the unpaid loan as a business bad debt deduction. The court held that the taxpayer’s involvement in the real estate investment was not a trade or business; therefore, the bad debt did not qualify as a business bad debt. The court also held that, because the Chapter 7 estate held assets for distribution to creditors, the taxpayer’s debt was not wholly worthless and was not entitled to a bad debt deduction. Scagliotta v. Comm’r, T.C. Memo. 1996-498.

The taxpayers owned a roofing company and personally guaranteed a line of credit for the company in order for the company to acquire supplies for a roofing job. The company failed to receive payment for that job, however, and was liquidated. The taxpayers claimed the guaranteed debt as a business bad debt deduction. The court allowed the business bad debt deduction because the taxpayers made the guarantee in order to protect their income from the business and not to protect their investment in the company. Rosenberg v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 50,583 (N.D. Ill. 1996).

COURT AWARDS AND SETTLEMENTS. The taxpayers received a judgment award in a negligence action. The award included prejudgment interest equal to 39 percent of the total award. While the case was on appeal, the parties settled for a specific amount, but the settlement did not include a specific apportionment for prejudgment interest. The IRS apportioned 39 percent of the settlement to prejudgment interest and assessed income tax as to that amount. The court upheld the IRS assessment because the taxpayers failed to provide evidence that the settlement intended a different apportionment. The prejudgment interest was taxable because it was not part of the damages awarded for personal injury. Delaney v. Comm’r, 96-2 U.S. Tax Cas. (CCH) ¶ 50,576 (1st Cir. 1996).

HOBBY LOSSES. The taxpayers were employed as registered nurses and also operated a medical records review service. The taxpayers purchased up to 10 Paso Fino horses
with the intent to breed them for sale to the public. The breeding business produced several years of increasing costs and tax losses which offset their substantial wages. The court looked at the nine factors of Treas. Reg. § 1.183-2(b) to determine that the breeding business was not operated with the intent to make a profit: (1) the taxpayers failed to formulate a plan to produce a profit from the business; (2) although the taxpayers had knowledge about the horses, the taxpayers failed to obtain expert advice about running a profitable breeding business; (3) the taxpayer expended sufficient time in the business; (4) the appreciation of the horses had no potential to offset the losses; (5) the taxpayer had not successfully operated a similar business before; (6) the business had a history of only losses; (7) the amount of income from the business was insubstantial in comparison to the losses; (8) the taxpayers’ other income was sufficient to maintain their standard of living while absorbing the losses; and (9) the taxpayers worked hard at the business but also received much personal pleasure from rural life and riding the horses. Thus, the taxpayer’s deductions from the business expenses were limited to the income from the business. Yates v. Comm’r, T.C. Memo. 1996-499.

IN Voluntary Conversion. The taxpayer was a limited partnership which formed a general partnership with a corporation for the purpose of purchasing real property. The property became the subject of governmental condemnation proceedings and an agreement to sell the property to the governmental entity was reached by the general partnership. Once the sale was assured and imminent, the general partnership transferred 50 percent tenant-in-common interests to the taxpayer and the corporation. The taxpayer used the proceeds of the sale to purchase similar property and sought allowance of like-kind tax-free transfer treatment for the sale and purchase. The IRS ruled that the sale of the original property was made by the general partnership and not by the taxpayer; therefore, the purchase of other property by the taxpayer did not qualify for like-kind exchange treatment. Ltr. Rul. 9645005, July 23, 1996.

Levy. The IRS has issued a table for determining the amount of wages, salary or other income exempt from levy for 1997. Notice. 96-56, I.R.B. 1996-47, 7.

The defendant hired the taxpayer to perform subcontracting services. The taxpayer had assigned its accounts receivable to a bank as security for a loan. On July 7, 1992, the IRS filed a tax levy on the defendant for taxes owed by the taxpayer. The bank notified the defendant of the assignment on July 9, 1992. The court held that the defendant was liable for the failure to pay the amount owed on the tax levy because the levy was filed prior to notification of the assignment. United States v. Giffels Associates, 96-2 U.S. Tax Cas. (CCH) ¶ 50,584 (E.D. Mich. 1996).

Penalties. The taxpayers were assessed additional taxes after an audit of their 1985-1986 returns. The taxpayers operated a substantial feedlot business with annual revenues over $6 million. In the audit, the IRS imposed a FIFO inventory system because the taxpayers had inadequate inventory records. The taxpayers were also found to have improperly reported an interest expense in the tax year before the interest was actually charged. The IRS disallowed a dependent deduction for the taxpayers’ daughter for the tax year the daughter was married, because the daughter and new husband filed a joint return. Finally, the taxpayers improperly claimed a business deduction for the use of three head of cattle to feed the taxpayers and their workers. The IRS assessed a penalty for substantial underpayment of taxes and the taxpayers sought a waiver of that penalty for acting in good faith. The court held that the penalty was justified for all but the interest deduction, because the taxpayers had relied on a bank statement that the interest was charged in the year for which the deduction was claimed. Walter v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 50,604 (D. S.D. 1996).

The IRS has issued proposed regulations concerning the reasonable basis standard for avoiding the accuracy-related, negligence, and substantial understatement of income penalties. Under the final regulations currently in place, the reasonable basis standard is "significantly higher than the not frivolous standard applicable to preparers under 6694." The proposed regulations provide that the reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. A return position will generally satisfy the reasonable basis standard if it is reasonably based on one or more of the authorities set forth in Treas. Reg. § 1.6662-4(d)(3)(iii). The proposed regulations also clarify that if a return position does not satisfy the reasonable basis standard, the reasonable cause and good faith exception as set forth in Treas. Reg. § 1.6664-4 may still provide relief from the penalty. 61 Fed. Reg. 58020 (Nov. 12, 1996).

The taxpayer was a corporation which had timely paid its taxes for 1983 but had obtained the automatic extension to file. When the taxpayer finally filed the 1983 return, the taxpayer claimed a refund because the timely tax payment exceeded the actual amount due. The taxpayer elected to apply the refund amount to the 1984 tax liability. However, upon review by the IRS, the 1983 refund amount was reduced. The IRS charged the taxpayer for interest on the excess refund claimed by the taxpayer from the date of the 1983 return. The IRS argued that once the refund was applied to the 1984 tax year, any deficiency would carry back to the 1983 return. The taxpayer argued that the 1983 taxes were fully paid and that the interest could not be charged until 1984 taxes were due but unpaid. The court held that the “use of money” principle applied to determine when interest on taxes begins to accrue. Because the taxpayer had no benefit from the erroneous refund claim until taxes became due in 1984, no interest could be charged until those taxes became due. The May Department Stores Co. v. United States, 96-2 U.S. Tax Cas. (CCH) ¶ 50,596 (Fed. Cl. 1996).

The IRS had determined that the taxpayer corporation had overpaid its 1981 tax but owed additional taxes for 1982 and 1983. The amount of the overpayments exceeded both of the deficiencies. The IRS paid interest on the entire 1981 overpayment until the due date of the return for 1982. The IRS then paid interest on the remaining overpayment until the due date for the 1983 return. The IRS then paid interest on the remaining overpayment until the date of repayment. For 1986, the taxpayer timely filed its return and claimed an overpayment of taxes. The taxpayer elected to apply the

* Agricultural Law Manual (ALM). For information about ordering the Manual, see the next to last page of this issue. *
overpayment to the 1987 taxes but did not designate as to which estimated tax payment the overpayment was to be applied. The IRS applied the overpayment to the first estimated tax payment and assessed interest on a 1988 deficiency from the date of the first estimated payment instead of the due date of the return. *Ltr. Rul. 9646001*, June 20, 1996.

**PENSION PLANS.** For plans beginning in November 1996, the weighted average was 6.91 percent with the permissible range of 6.22 to 7.46 percent (90 to 109 percent permissible range) and 6.22 to 7.60 percent (90 percent permissible range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). *Notice 96-59, I.R.B.*

**SAFE HARBOR INTEREST RATES**

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</table>

**SALE OF ASSETS.** The taxpayer was the sole shareholder, chief executive officer and director of a corporation which manufactured paint sprayers. The taxpayer owned several horses which the taxpayer wanted to sell. The taxpayer had title to the horses secretly transferred to a new subsidiary of the corporation. The purpose of the transfer was to have the corporation sell the horses and recognize any gain which would be eligible for offset by net operating loss carryforwards held by the corporation. The management of the horses did not change after the transfer and other directors and employees of the corporation were not informed about the horse transfer and sales. The court held that the taxpayer was required to recognize any gain from the sale of the horses because the corporation was merely a conduit for the sale. The court noted that the transfer of the horses to the corporation served no business purpose of the corporation and was made primarily for tax advantages. *Estate of Kluener v. Comm'r*, T.C. Memo. 1996-497.

**TRUSTS.** The taxpayer established a trust to be funded with S corporation stock. The trust provided that the trustee had the power to lend money from the trust to the taxpayer without providing security for the loan. The trustee could irrevocably release or waive this power. The taxpayer had the power to acquire trust property by substituting property of equivalent value. The IRS ruled that the trust was a grantor trust such that the taxpayer was liable for any tax on trust income. *Ltr. Rul. 9645013, Aug. 9, 1996.*

The taxpayer was the owner of a grantor trust which had income from the renting of safe deposit boxes. The trust filed a “1041 Supplement” showing income of $87,519 but the taxpayer reported income from the trust of only $74,955, claiming that the taxpayer was entitled to more depreciation than was claimed by the trust. The court found that the trust was a grantor trust; therefore, the income and deductions from the rental of the safe deposit boxes was treated as if the boxes were owned by the taxpayer. The additional depreciation was not allowed because the taxpayer failed to provide evidence of the basis of the boxes for determining the appropriate depreciation. *Bresnahan v. Comm'r*, T.C. Memo. 1996-497.
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